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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIFTH APPELLATE DISTRICT

KERMAN TELEPHONE CO.,

Petitioner,

v.

PUBLIC UTILITIES COMMISSION,

Respondent.

F076776

(CPUC Decision No. 17-11-036)

OPINION

ORIGINAL PROCEEDINGS; petition for writ of review.

Cooper, White & Cooper, Mark P. Schreiber, Patrick M. Rosvall, Sarah J. Banola, and Priya D. Brandes for Petitioner.

Arocles Aguilar, Helen W. Yee, and Lindsay Brown for Respondent.

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In this original writ proceeding, petitioner Kerman Telephone Co. (Kerman) challenges California's Public Utilities Commission (Commission) Resolution T-17531 (the resolution) and the order denying Kerman's application for rehearing of the resolution, Decision No. 17-11-036 (the rehearing decision). The resolution and rehearing decision concerned a true-up of interim rate relief, which Kerman received during the last six months of the proceeding on its general rate case (GRC) application, to

the final adopted rates. The Commission determined that under the methodology specified in the decision granting interim rate relief and the final decision on Kerman's application, Kerman was required to refund all the interim rate relief it received.

Kerman contends the resolution and rehearing decision: (1) conflict with "unambiguous directives in two Commission decisions regarding how to implement the 'true-up' of interim rate relief and ensure that Kerman received sufficient revenue," therefore, the Commission failed to proceed in a manner required by law and abused its discretion; (2) violated Kerman's constitutional and statutory rights by wrongfully denying Kerman's ability to earn its authorized rate of return and unlawfully taking Kerman's property; and (3) violated Kerman's due process rights and statutory requirements by altering the basis for the Commission's conclusions without permitting comment on the new grounds. Kerman asks us to annul the resolution and rehearing decision and instruct the Commission to perform the proper true-up calculation.

We find merit to Kerman's first contention and agree the Commission abused its discretion, as it has not provided a rational explanation for the methodology it used in calculating the true-up. Therefore, we annul the resolution and rehearing decision, and remand for the Commission to reconsider the matter.

FACTUAL AND PROCEDURAL BACKGROUND

Kerman is a small local telephone company serving approximately 4,000 residential and small business customers in the City of Kerman and nearby rural areas west of Fresno. As a small independent telephone corporation that is a carrier of last resort, Kerman is eligible for the California High-Cost Fund-A Administrative Committee Fund (CHCF-A) program pursuant to Public Utilities Code¹ section 275.6.²

¹ Undesignated statutory references are to the Public Utilities Code.

² The CHCF-A fund program provides "universal service rate support to small independent telephone corporations in amounts sufficient to meet the revenue requirements established by the commission through rate-of-return regulation in

The CHCF-A program is funded by surcharges assessed against all California telephone customers. (*The Ponderosa Telephone Co. v. Public Utilities Com.* (2011) 197 Cal.App.4th 48, 52 (*Ponderosa*).)

The Commission periodically establishes the rates Kerman charges for telephone service in GRC proceedings using a cost-of-service or rate-of-return model. (§ 275.6, subd. (c)(2); see *Ponderosa, supra*, 197 Cal.App.4th at p. 51.) Under this structure, the Commission examines Kerman’s costs in a test year and determines its revenue requirement during that test year. (*Ponderosa*, at p. 51.) The revenue requirement is the amount necessary for Kerman “to recover its reasonable expenses and tax liabilities and earn a reasonable rate of return on its rate base.” (§ 275.6, subd. (b)(5).) Once the Commission establishes Kerman’s revenue requirement, it “fashions a rate design” comprised of end user rates, high-cost support, and other revenue sources that affords Kerman “a fair opportunity to meet the revenue requirement.” (§ 275.6, subd. (b)(3) & (4).) A rate design is developed by (1) setting end user rates that are “just and reasonable”; (2) projecting revenue to be derived from those rates; (3) adding that revenue projection to the projections for fixed revenue sources; and (4) subtracting the total from the company’s revenue requirement. The resulting difference is the subsidy the company receives from the CHCF-A program. (§ 275.6, subd. (c)(3) & (4).)

The revenue used to fulfill Kerman’s revenue requirement comes from five principal sources: (1) “local network services” or customer rates; (2) CHCF-A support; (3) interstate Universal Service Fund (USF) support; (4) intrastate network access services; and (5) miscellaneous intrastate revenues less uncollectible revenue. (*Kerman Telephone Co.* (2016) Cal. P.U.C. Dec. No. 16-06-053 (the final rate decision), Appen.

furtherance of the state’s universal service commitment to the continued affordability and widespread availability of safe, reliable, high-quality communications services in rural areas of the state.” (§ 275.6, subd. (a).)

A.) The last three revenue sources are essentially fixed inputs that cannot be changed through the general rate case process.

Kerman's GRC Application

In December 2011, Kerman filed a GRC application, No. A 11-12-011, seeking a review of its revenue requirement and a \$2.957 million increase in net intrastate revenues, which equated to a proposed CHCF-A draw for test year 2013 of \$6.49 million. Kerman's application did not request a change to its basic residential local exchange rate, but requested other selected rate changes. In January 2012, the Division of Ratepayer Advocates (DRA)³ protested Kerman's application.

Following a series of procedural delays, Kerman's application proceeded using 2016 as the test year. In January 2015, Kerman updated its revenue and expense estimates for the 2016 test year, forecasting an intrastate revenue requirement of \$10,274,968 and increased CHCF-A subsidy of \$6,011,945, which was 70 percent higher than the \$3,539,725 CHCF-A support previously authorized for 2016. Kerman later revised the 2016 revenue requirement to \$10,442,787 based on its audited end-of-year financials.

Kerman's Third Motion for Interim Rate Relief

In January 2016, Kerman filed its third motion for interim rate relief.⁴ Kerman asserted that during the lengthy delay between the filing of its GRC application and a final resolution, its earnings had fallen short of its 10 percent authorized rate of return, as it earned 6.11 percent in 2013 and 4.45 percent in 2014. Kerman's motion relied on an

³ In September 2013, the DRA was renamed the Office of Ratepayer Advocates.

⁴ The Commission denied Kerman's first motion for interim rate relief, filed in January 2013, by which Kerman sought additional CHCF-A funds for 2013 until a final decision was reached on its application. The Commission did not rule on Kerman's second motion for interim rate relief, filed in December 2014, by which Kerman sought to have the ratemaking decisions effective as of January 1, 2015, and an increase in its revenue requirement.

inflationary metric to reflect the increase in the price of goods and services since January 2008, when its current rate structure went into effect. Kerman used the Gross Domestic Product Price Index (GDPPI) to grow its revenue requirement from January 2008 and then calculated a resulting CHCF-A draw.

On February 25, 2016, the Commission issued Decision No. 16-02-022 (the interim rate relief decision) granting Kerman's unopposed motion and permitting Kerman "to increase, on an interim basis, its annual draw from the California High Cost Fund A (CHCF-A), effective February 1, 2016, and subject to true-up." In the discussion section of the decision, the Commission stated that interim rate relief was warranted by Kerman's uncontested factual allegations and equitable showings, and Kerman's evidence, assuming it was accurate, supported granting the motion. The Commission explained that Kerman's Regulatory Manager, David Clark, performed a calculation to adjust Kerman's current revenue requirement of \$8,801,394, which was set by Kerman's 2008 GRC application, for inflationary increases through 2016 based on the GDPPI, resulting in a 2016 revenue requirement of \$9,913,767. The amount of the interim draw thus was \$1,112,373, the difference between the 2008 and projected 2016 revenue requirements.

The Commission stated that granting Kerman interim relief would not harm Kerman's ratepayers or the contributors to the CHCF-A, as the interim draw authorized in the decision would be "subject to true-up and possible refund." The Commission stated: "If Kerman's final CHCF-A draw is less than the interim draw, Kerman will return the difference to the CHCF-A. If the ultimate draw at the conclusion of the proceeding is larger than the interim draw, additional CHCF-A would be available to make up the difference back to February 1, 2016." In addition, the Commission determined interim rate relief was supported by applicable law, as there had been delays in the resolution of the proceeding, and Kerman "provided a sufficient rationale to grant its motion and allow the additional draw from the CHCF-A, subject to true-up."

The Commission granted the motion, set Kerman's interim relief at \$1,112,373 payable from the CHCF-A, and ordered the Commission's Communications Division (CD) to divide the \$1,112,373 into 12 monthly payments and combine the additional February interim relief amount with the February CHCF-A payment in early March 2016, and make each succeeding monthly payment in 1/12th increments. In Ordering Paragraph 4, the Commission determined the payments authorized by the decision "shall be subject to true-up and possible refund. The refund, if any, shall be a one-time lump sum payment from Kerman to the California High Cost Fund A (CHCF-A) fund with interest calculated using the 3-month commercial paper rate from the date of payment by the CD. The lump sum refund, including interest, shall be paid by Kerman within 45 days from the effective date of the final order in this application. On the other hand, if the ultimate draw at the conclusion of the proceeding is larger than the interim draw, additional CHCF-A shall be available to make up the difference back to February 1, 2016."

The Final Rate Decision

The Commission issued its decision on Kerman's GRC application for the 2016 test year on June 23, 2016. (*Kerman Telephone Co.* (2016) Cal. P.U.C. Dec. No. 16-06-053.) The Commission set Kerman's operating revenues at \$8,795,090, which included CHCF-A support of \$4,177,111,⁵ and its operating expenses at \$7,499,710, leaving Kerman net revenues of \$1,295,380, which is equivalent to a 10 percent rate of return. The rates became effective August 1, 2016.

In Ordering Paragraph 2, the Commission directed Kerman to "file a Tier 3 Advice Letter to true-up the difference between interim rates, including 2016 California

⁵ The \$8,795,090 in total operating revenue was comprised of: (1) \$2,036,922 from local network services; (2) \$4,177,111 in CHCF-A support; (3) \$2,032,176 from interstate USF; (4) \$252,299 from intrastate network access services; and (5) \$301,901 from miscellaneous sources less \$5,319 in uncollectible revenue.

High Cost Fund-A support and interim rate relief, for the period January 1, 2016 to the implementation date of the rates adopted in this order.... The process for the true-up shall be in accordance with Ordering Paragraph 4 from [the interim rate relief decision], which we set forth verbatim: [¶] The payments to Kerman ... authorized by this decision shall be subject to true-up and possible refund. The refund, if any, shall be a one-time lump sum payment from Kerman to the ... (CHCF-A) fund with interest calculated using the 3-month commercial paper rate from the date of payment by the CD. The lump sum refund, including interest, shall be paid by Kerman within 45 days from the effective date of the final order in this application. On the other hand, if the ultimate draw at the conclusion of the proceeding is larger than the interim draw, additional CHCF-A shall be available to make up the difference back to February 1, 2016.”

In Ordering Paragraph 12, the Commission ordered Kerman to follow the directions of the CD in order to comply with the final rate decision’s requirements.

Kerman’s Tier 3 Advice Letter

On July 29, 2016, Kerman filed an advice letter, Tier 3 AL-407 (the advice letter), to true-up its interim rate relief adopted in the interim rate relief decision with the final rate adjustments and funding levels established in the final rate decision. Kerman stated it had discussed the necessary true-up calculations with the CD following adoption of the final rate decision and the adjustments reflected in the advice letter were submitted in accordance with the CD’s direction.

Kerman determined it owed the CHCF-A fund a \$13,935 refund. Kerman calculated this amount by adding six months of increases in CHCF-A funding and local service rates the Commission granted in the final rate decision (from February through July 2016), which totaled \$463,591, and subtracting that amount from the six monthly payments of interim rate relief it received during that same time period, which totaled \$556,187. This left a true-up amount of \$92,595. From this, Kerman subtracted an

interest rate adjustment and “ARC true up from Company forbearance,”⁶ leaving a net true-up amount of \$13,935 due the CHCF-A fund.

Draft Resolution T-17531

On November 15, 2016, the Commission issued a draft resolution on Kerman’s advice letter. The Commission proposed ordering Kerman to refund \$561,573.78 to the CHCF-A.

The Commission explained that Kerman’s true-up calculations used a methodology that compared the six-month period (February through July 2016) during which the CHCF-A provided interim rate relief against the differential between GRC-adopted and previously approved CHCF-A program support, plus GRC-adopted local service rate increases.

The CD analyzed Kerman’s calculations and rejected them because they were inconsistent with the interim rate relief decision. The CD noted the Commission calculated the interim rate relief by subtracting Kerman’s 2008 operating revenue from Kerman’s proposed 2016 operating revenue. Kerman’s calculations, however, deviated from this methodology as they: (1) excluded local network services, interstate USF, intrastate network access services, and miscellaneous and uncollectible revenue; (2) isolated and compared only the CHCF-A support the Commission adopted for test year 2016 to the CHCF-A support adopted for calendar year 2016, instead of comparing “the entire operating revenue adopted for 2016 against the interim operating revenues adopted” in the interim rate relief decision; and (3) included the Access Recovery Charge revenue.⁷

⁶ According to Kerman, while its advice letter addressed a “separate issue regarding the Access Recovery Charge (ARC),” that issue is being handled through a separate process and is not relevant to its petition.

⁷ The Commission stated that if Kerman wished to recover the ARC revenue, it was required to file a separate advice letter seeking determination of the issue.

The CD's true-up calculations, which it claimed were in accordance with the interim rate relief decision, subtracted test year 2016 total operating revenue of \$8,795,090, which was adopted in the final rate decision, from the test year 2008 total operating revenue of \$8,801,394—the difference between the two showed that Kerman's 2016 operating revenue was \$6,304 less than the amount adopted for 2008. The CD concluded that because there was no positive revenue requirement differential, the full amount of interim rate relief was subject to refund to the CHCF-A fund. Therefore, Kerman was required to refund the entire amount of interim rate relief received, \$556,186.50, plus interest, as directed by the interim rate relief decision, for a total refund of \$561,573.78. The draft resolution contained 13 findings and one order requiring Kerman to make a one-time lump sum payment to the CHCF-A fund.

Kerman's Opening Comments Concerning the Draft Resolution

On December 5, 2016, Kerman submitted opening comments on the original draft resolution. Kerman argued the draft resolution was unlawful because it used methodology at odds with “unambiguous Commission direction” in the GRC proceeding and “every previous Commission precedent” regarding the calculation of interim rate relief true-up for a small telephone company. Kerman also argued the draft resolution deprived Kerman of funding the Commission had conclusively determined was necessary for Kerman to meet its revenue requirement.⁸ Kerman asserted a “correct application of the law and a faithful implementation of the Commission's intent in resolving Kerman's rate case results in a ‘true up’ figure of \$17,934,” which Kerman owed the CHCF-A fund.

⁸ Kerman asserted that after the final rate decision was issued, it worked with CD representatives for several weeks to agree upon a reasonable and accurate interim rate relief true-up, but an apparent staffing change within CD management appeared to have reversed those efforts, “resulting in an entirely different outcome that cannot be justified based on the applicable decisions or operative facts.”

Kerman stated the question presented by the draft resolution was how to “true up” the six months of interim rate relief it received pursuant to the interim rate relief decision. Kerman claimed the true-up involved four steps:

(1) determine the difference between Kerman’s final CHCF-A draw and the interim draw, as directed by the interim rate relief decision, which totaled \$237,486;

(2) to ensure Kerman received the full amount of CHCF-A deemed reasonable in the final rate decision for the 2016 test year, an additional \$53,116 should be provided to Kerman for the month of January 2016, which is the difference between Kerman’s actual CHCF-A draw for January 2016 and the monthly CHCF-A draw the final rate decision determined Kerman was entitled to for 2016;

(3) since the final rate decision adopted end user rate increases of \$285,382, which did not take effect until August 1, 2016, Kerman was entitled to additional interim rate relief of \$166,473 to ensure the results of Kerman’s rate case became effective as of January 1, 2016, as contemplated in the interim rate relief decision; and

(4) the Commission should apply the 90-day financial commercial paper rate to the resulting figure, which the draft resolution miscalculated.

Kerman argued the Commission should withdraw the draft resolution and produce a revised draft resolution based on these calculations.

The Revised Draft and Final Resolutions

On February 6, 2017, the Commission released revised draft resolution T-17531, which rejected Kerman’s arguments and proposed to require Kerman to refund \$559,783.78 to the CHCF-A fund, which the Commission adopted three days later. On February 14, 2017, the Commission issued Resolution T-17531, which directed Kerman to refund \$559,783.78 to the CHCF-A fund.

The resolution discussed the CD’s analysis of Kerman’s true-up calculation. The CD recommended the Commission reject Kerman’s calculation because it was inconsistent with the methodology established in the interim rate relief decision and

reaffirmed in the final rate decision. The CD asserted “[t]he true-up should compare the adopted interim rates to adopted final rates for Test Year 2016,” and since the final revenue requirement adopted in the final rate decision (\$8,795,090) is less than the interim revenue requirement adopted in the interim rate relief decision (\$9,913,767), the true-up calculation and repayment should be based on that differential.

The CD’s true-up calculation was based on two Commission-prescribed tests. The first test compared the total revenue requirements, which the CD asserted was in accordance with the interim rate relief decision. The CD compared “the Test Year 2016 total operating revenue adopted in [the final rate decision] and 2016 interim rate relief total operating revenue adopted in [the interim rate relief decision] to determine the revenue requirement differential.” This calculation showed Kerman’s 2016 operating revenue of \$9,913,767, adopted in the interim rate relief decision, was \$1,118,677 more than the \$8,795,090 operating revenue adopted in the final rate decision; therefore, the interim rate relief was subject to refund to the CHCF-A fund.

The second test compared the CHCF-A draws to determine whether there was a differential between Kerman’s interim CHCF-A draw authorized in the interim rate relief decision and the test year 2016 CHCF-A draw adopted in the final rate decision. The CD determined Kerman did not qualify to receive any additional CHCF-A payments, as the test year CHCF-A draw of \$4,177,111 was less than the interim CHCF-A draw of \$4,652,098. Moreover, the second test demonstrated the interim rate relief Kerman received must be refunded.

The resolution explained: “The revenue requirement methodology that CD used in determining Kerman’s true-up is standard Commission practice. The total revenue requirement comparison CD made is an established procedure used for water utilities in performing true-up for interim rate relief; it is appropriate for CD to follow a similar practice for this true-up.”

The Commission concluded Kerman must refund \$559,783.78 to the CHCF-A fund. This amount was calculated by dividing the \$1,118,677 revenue requirement differential derived in the first test by 12, which equals \$93,223.08 in monthly CHCF-A support in excess of the final rates, and multiplying that by six, which was the number of months Kerman received the interim rate relief. The total monthly CHCF-A support in excess of final rates thus was \$559,338.48. When interest of \$445.30 was added, Kerman was required to refund \$559,783.78.

The Commission reviewed and addressed Kerman's comments on the draft resolution. The Commission agreed with Kerman that the interest calculation was not computed properly and revised the interest calculation accordingly. The Commission asserted the resolution followed the methodology set forth in the interim rate relief and final rate decisions, and Kerman did not provide evidence to support its true-up calculation. Because the interim rate relief decision stated the true-up was only for the period back to February 1, 2016, no amount was subject to refund for January 2016. The Commission explained that because it accepted Kerman's revenue requirement forecast for 2016 in adopting interim rate relief, and the relief was based on the difference between that forecast and Kerman's last adopted revenue requirement, the differential between prior and current CHCF-A support was not a factor in the true-up calculation. Instead, the resulting comparison between prior and currently adopted revenue was the relevant consideration.

The Commission made 16 findings and conclusions. The Commission ordered that, in compliance with Ordering Paragraph 4 of the interim rate relief decision, and Ordering Paragraphs 2 and 12 of the final rate decision, Kerman shall make a one-time lump sum payment to the CHCF-A of \$559,783.78, within 45 days from the effective date of the resolution.

The Application for Rehearing

Kerman filed an application for rehearing of the resolution on March 16, 2017, which the Commission denied on December 5, 2017, in its “Order Denying Rehearing of Resolution T-17531,” Decision No. 17-11-036.

DISCUSSION

I. Standard of Review

Under section 1756, this court has jurisdiction to review Commission decisions through petitions for writ of review. (§ 1756, subd. (a).)⁹ Before seeking judicial review, the aggrieved party must exhaust its administrative remedies by filing an application for rehearing, which must raise each issue the party intends to raise in the Court of Appeal. (*San Pablo Bay Pipeline Co. LLC v. Public Utilities Com.* (2013) 221 Cal.App.4th 1436, 1443 (*San Pablo Bay*); §§ 1732, 1756, subd. (a).) Consequently, matters before this court will involve the Commission’s resolution and subsequent decision denying Kerman’s application for rehearing.

This court’s review of the Commission’s decisions is governed by section 1757, which limits our review to determining “whether the Commission (1) acted without, or in excess of, its jurisdiction; (2) proceeded in the manner required by law; (3) issued a decision not supported by the findings; (4) made findings not supported by substantial evidence in light of the whole record; (5) abused its discretion; or (6) violated a constitutional right.” (*San Pablo Bay, supra*, 221 Cal.App.4th at p. 1443, citing § 1757, subd. (a).)

Since the Commission is not an ordinary administrative agency, but rather a constitutional body with broad legislative and judicial powers, its decisions are presumed valid. (*Ponderosa, supra*, 197 Cal.App.4th at p. 56.) The Commission’s findings based

⁹ While our review is discretionary, rather than mandatory, because petitions for writ of review effectively serve as appeals, they are not to be summarily denied on policy grounds unrelated to their merits. (*Ponderosa, supra*, 197 Cal.App.4th at pp. 55-56.)

on conflicting evidence, or undisputed evidence from which conflicting inferences reasonably may be drawn, are final and not subject to review. (*City and County of San Francisco v. Public Utilities Com.* (1985) 39 Cal.3d 523, 530-531.) “The only exception is those findings or conclusions ‘drawn from undisputed evidence ... from which conflicting inferences may not reasonably be drawn [and therefore] present questions of law.’ ” (*Pacific Gas & Electric Co. v. Public Utilities Com.* (2015) 237 Cal.App.4th 812, 839.)

Where a Commission decision is challenged on the ground it violates a constitutional right, the reviewing court must exercise independent judgment on the law and facts, and the Commission’s findings or conclusions material to the constitutional question are not final. (§ 1760.) Nevertheless, “we may not substitute our own judgment ‘as to the weight to be accorded evidence before the Commission or the purely factual findings made by it.’ ” (*SFPP, L.P. v. Public Utilities Com.* (2013) 217 Cal.App.4th 784, 794.)

II. The True-Up Methodology

Kerman contends the Commission’s resolution and rehearing decision fail to effectuate the true-up required by the interim rate relief and final rate decisions. Kerman argues the parameters of the true-up are “unambiguous.” In Kerman’s view, they require accounting for the period of time when it operated under an interim rate structure and ensure it is provided proper revenues for the 2016 test year consistent with the revenue amounts adopted in the final rate decision. Kerman contends that because the resolution and rehearing decision fail to execute these directives, the Commission failed to proceed in the manner required by law and abused its discretion. (§ 1757, subd. (a)(2) & (5).)

In assessing whether the Commission proceeded in the manner required by law, “ ‘ we are mindful that “[t]here is a strong presumption of validity of the [C]ommission’s decisions” ’ [Citation.] The Commission’s interpretation of its own rules and regulations ‘is entitled to consideration and respect by the courts.’ [Citation.] We will

not interfere with the Commission's choice of procedures 'absent a manifest abuse of discretion or an unreasonable interpretation of the statutes governing its procedures.' [Citation.] In addition, if we conclude the Commission has failed to proceed in the manner required by law, we will annul its decision only if that failure was prejudicial." (*The Utility Reform Network v. Public Utilities Com.* (2014) 223 Cal.App.4th 945, 958.)

In determining whether the Commission abused its discretion, we consider whether the Commission exceeded the bounds of reason. (*San Pablo Bay, supra*, 221 Cal.App.4th at p. 1460.) While we do not substitute our judgment for that of the Commission, the Commission must "articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.' " (*Motor Vehicle Mfrs. Assn. v. State Farm Mut.* (1983) 463 U.S. 29, 43; see, e.g., *McPherson v. Public Employment Relations Bd.* (1987) 189 Cal.App.3d 293, 308-309.) A failure to adequately explain the basis for an agency's decision that is rationally related to the relevant factors may be grounds for annulment. (See, e.g., *McBail & Co. v. Solano County Local Agency Formation Com.* (1998) 62 Cal.App.4th 1223, 1232.)

Here, the Commission calculated the true-up based on the difference between Kerman's revenue requirement adopted in the final rate decision and the revenue requirement Kerman estimated for 2016 when moving for interim rate relief. The Commission stated it based the true-up calculation on the interim rate relief and final rate decisions, which provided directions for how Kerman's true-up should be calculated, and followed the methodology set forth in these decisions. The directions for calculating the true-up and methodology to be used, however, are less than clear.

The interim rate relief decision stated in Ordering Paragraph 4 that the payments are "subject to true-up and possible refund" in the form of a "one-time lump sum payment" to the CHCF-A fund with interest and, "[o]n the other hand, if the ultimate draw at the conclusion of the proceeding is larger than the interim draw, additional CHCF-A shall be available to make up the difference back to February 1, 2016." While

this paragraph states how to calculate the true-up if the CHCF-A support designated in the final rate decision is greater than the interim draw, it says nothing about how to calculate the true-up if that is not the case. That methodology can be gleaned from the discussion section, however, which stated that “[i]f Kerman’s final CHCF-A draw is less than the interim draw, Kerman will return the difference to the CHCF-A.” It appears from these statements that the true-up was intended to compare the CHCF-A draws, not the revenue requirements. Although the interim rate relief decision based the interim rate relief on the difference between Kerman’s estimated revenue requirement for test year 2016 and Kerman’s 2008 revenue requirement, the decision does not state the true-up would be calculated based on a comparison of revenue requirements.

The final rate decision does not clarify the methodology to be used. Ordering Paragraph 2 of that decision directs Kerman to file an advice letter “to true-up the difference in interim rates, including 2016 [CHCF-A] support and interim rate relief, for the period January 1, 2016 to the implementation date” of the final rates, and further states “[t]he process for the true-up shall be in accordance with Ordering Paragraph 4” of the interim rate relief decision. While Ordering Paragraph 4 does provide a process for the true-up, as it specifies how and when Kerman must pay any refund to the CHCF-A fund, as we have already explained, it does not specify the methodology for calculating the true-up where, as here, the CHCF-A draw adopted in the final rate decision is less than the interim draw. The instruction to “true-up the difference between interim rates, including 2016 [CHCF-A] support and interim rate relief,” from January 1, 2016, to the implementation date of the final rates does not clarify matters, as it does not define the term “interim rates,” which could be interpreted as a simple comparison of CHCF-A draws, and provides a period for the true-up that is one month greater than the true-up period specified in Ordering Paragraph 4.

While in the face of these ambiguities we normally would defer to the Commission’s interpretation of these decisions, we decline to do so because there is no

support for its interpretation. The Commission contends it acted consistent with the interim rate relief and final rate decisions, but does not explain how those decisions support the revenue requirement methodology it adopted. Neither decision uses the term “revenue requirement” with respect to the true-up calculation. While the Commission asserts the revenue requirement methodology is “standard Commission practice,” the Commission does not explain the source of that practice. To the contrary, the Commission concedes that neither it nor Kerman could locate recent examples of precedents that calculated a true-up for a telecommunications company.

In the absence of any precedent, the Commission asserts it was reasonable to look at “ ‘an established procedure for water utilities in performing true-ups for interim rate relief,’ ” namely, the total revenue requirement comparison. The Commission, however, does not point to any source of this “established procedure.”

Kerman asserts the water company rate cases do not provide support for the Commission’s test, citing section 455.2.¹⁰ Section 455.2 provides that if the Commission’s decision on a water corporation’s GRC application is not effective on the first day of the first test year in the application, the applicant may file a “tariff implementing interim rates,” which would be effective on the first day of the first test year in the application and “subject to refund.” (§ 455.2, subd. (b).) Moreover, the interim rates “shall be adjusted upward or downward back to the interim rate effective date, consistent with the final rates adopted by the commission,” although the Commission may authorize a lesser increase if it finds the rates are in the public interest. (§ 455.2, subd. (b).)

¹⁰ Section 455.2 applies to water corporations with greater than 10,000 service connections. (§ 455.2, subd. (a).) It requires the Commission to issue its final decision on such a water corporation’s GRC application to ensure it becomes effective on the first day of the first test year in the application. (*Ibid.*)

Kerman cites water company cases in which the Commission applied this methodology in performing true-ups, which compare interim rates actually received to rates ultimately adopted for the months the interim rates were collected. (*California-American Water Company* (2006) Cal. P.U.C. Dec. No. 06-11-050, pp. 97-98 [true-up of interim rates resulted in surcharge for period since January 1, 2006, calculated based on the actual loss or gain in each district's revenue, determined by applying the rate differential to the actual quantities of water sales and actual number of customers]; *California Water Service Company* (2007) Cal. P.U.C. Dec. No. 07-12-055, pp. 71, 78, 82 [applying same true-up methodology].)

The Commission has no response to Kerman's reliance on these water cases. Instead, it claims "the result of the true-up would have been the same no matter what industry the Commission looked to in determining how to calculate the true-up for Kerman in this case. A true-up involves a revenue requirement comparison, and it is evident that Kerman overcollected on its 2016 revenue requirement." The Commission, however, does not cite any authority to support its assertion that a true-up involves a revenue requirement comparison, such as the one the Commission conducted here. The Commission claims the interim rate relief and final rate decisions "were explicit that two things were to be compared—the interim rates and the adopted final rates for Test Year 2016," and then performs that comparison, not using the interim and final rates, but rather the interim and final revenue requirements.

The unreasonableness of the Commission's approach is apparent in the result, as subtracting the final rate decision's revenue requirement (\$8,795,090) from Kerman's estimated revenue requirement in the interim rate relief decision (\$9,913,767) results in Kerman being required to refund the CHCF-A fund *more* than it received in interim rate relief.¹¹ The Commission responds that Kerman is "fixated on a claimed difference of

¹¹ The difference of \$1,118,677 (\$9,913,767 minus \$8,795,090) divided by 12 months equals a monthly refund of \$93,223.08. The interim rate relief Kerman received

\$526.08 per month between what it says it received for six months and the Commission’s accounting of what [Kerman] received. [Citation.] Commission Staff carefully reviewed the data, and determined the correct amount that [Kerman] received. And even [Kerman] admits this is a ‘small difference,’ and as this difference has no impact on the calculations at issue, this argument is not relevant and should be rejected.” But the determination the Commission made was not what Kerman actually received in interim rate relief, but rather the “monthly CHCF-A support in excess of final rates.” Moreover, this determination is contrary to the statement in the interim rate relief decision that “[i]f Kerman’s final CHCF-A draw is less than the interim draw, Kerman will return the difference to the CHCF-A.” The decision does not state, as the Commission appears to assert, that Kerman would be required to refund more than this difference.

As the Commission’s true-up calculation is not supported by the record or any authority, we conclude the Commission abused its discretion in adopting the resolution and denying Kerman’s petition for rehearing, which requires annulment of both.

While Kerman urges us to instruct the Commission to follow Kerman’s true-up calculation, we are not convinced that calculation is mandated by the interim rate relief and final rate decisions given their ambiguities. Based on the statement in the final rate decision that the true-up should be based on the “difference between interim rates, including 2016 [CHCF-A] support and interim rate relief, for the period January 1, 2016 to the implementation date” of the final rates, Kerman asserts the “end result of the ‘true-up’ methodology” is to adjust its revenues to put it in the same ratemaking position it would have been in had the final rate structure been in place since January 1, 2016. Thus, Kerman claims that unless the true-up calculation includes differentials in the CHCF-A

from the CHCF-A fund pursuant to the interim rate relief decision, however, was \$92,697.75 per month (\$1,112,373 divided by 12).

draws and end user revenues from January through July 2016, it will experience an impermissible revenue shortfall for 2016.¹²

But it is not clear to us that this is what the interim rate relief and final rate decisions require, as the decisions say nothing about using the true-up process to place Kerman in the position it would have been in had the final rates become effective January 1, 2016. While the final rate decision uses the term “interim rates,” it does not define the term and it is entirely possible the Commission intended the true-up to ensure Kerman received the correct amount of interim rates, not to cure any shortfall between the interim rates and those adopted in the final rate decision.

Moreover, Kerman does not cite any authority that compels a finding that Kerman’s true-up calculations are mandated by the interim rate relief and final rate decisions. Kerman contends the Commission endorsed the same true-up methodology ordered in the interim rate relief decision in a prior proceeding involving Kerman, namely, *Kerman Telephone Co.* (2003) Cal. P.U.C. Decision No. 03-03-009. In that GRC proceeding, the Commission granted Kerman’s motion for interim rate relief and gave Kerman an interim rate increase via an additional \$1,937,350 draw from the CHCF-A fund. (*Id.* at pp. 1, 12.) The Commission concurred with Kerman’s proposal that its interim rate increase was subject to true-up in the final order to reflect any adjustments to the 2003 test year, and envisioned that if adjustments were made, the difference between Kerman’s request and the ultimate rate awarded would be refunded in a lump sum with interest to the CHCF-A fund in the form of a credit to Kerman’s 2003 draw from the fund. (*Id.* at p. 13.)

¹² Kerman calculates the \$17,897 true-up it claims it owes the CHCF-A fund as follows: (1) \$237,486, which Kerman owes for the CHCF-A differential from February through July 2016; (2) less \$53,116, which is owed Kerman for the CHCF-A differential for January 2016; (3) less \$166,473, which is owed Kerman for the local service revenues differential from January to July 2016.

The Commission ultimately issued an opinion approving a settlement between Kerman and the Office of Ratepayer Advocates, which established Kerman's final rates. (*Kerman Telephone Co.* (2003) Cal. P.U.C. Dec. No. 03-10-006.) The Commission explained the interim increase it gave Kerman was subject to true-up, "that is, Kerman would reflect any adjustments to its 2003 Test Year final revenue rate award," and based on the settlement agreement, Kerman was required to repay \$515,022 to the CHCF-A fund, which was an overcollection for 2002. (*Id.* at pp. 2-3, 8-9.)

Kerman asserts the methodology stated in these decisions shows the Commission here should have compared the differential between the final CHCF-A draw and the interim draw. Even if true, it does not support Kerman's calculations, which include credits to it for the January 2016 CHCF-A draw and the shortfall in end user revenue for the first seven months of 2016.

Simply put, the Commission has not provided a rational explanation for the methodology it used in calculating the true-up and Kerman has not convinced us that its methodology is correct. In this situation, where the true-up calculation is unclear and the Commission has not articulated reasons for its resolution that are rationally related to the interim rate relief and final rate decisions, we must remand the matter for the Commission to reconsider Kerman's advice letter.¹³

¹³ Since we are annulling the resolution and rehearing decision, we do not address Kerman's alternative contentions that (1) the Commission's refusal to fulfill Kerman's 2016 revenue requirement constituted an unconstitutional taking of Kerman's property and violated section 275.6, subdivision (a), and (2) violated the mandatory notice and comment requirements in adopting the resolution.

DISPOSITION

Resolution T-17531 and the rehearing decision (Decision No. 17-11-036) are annulled. The cause is remanded to the Commission to reconsider Kerman's Tier 3 AL-407 advice letter. Petitioner shall recover its costs in this proceeding. (Cal. Rules of Court, rule 8.493(a)(1)(A).)

DE SANTOS, J.

WE CONCUR:

SMITH, Acting P.J.

SNAUFFER, J.